

# Governance and Tax-Exempt Organizations

2009 CPE Training

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# Why We are Here and What We Hope to Accomplish

- Provide context within which nonprofit governance has become an area of focus by IRS and others
- Describe ongoing discussion over the roles of the IRS, the states, and the sector in NP governance
- Explain how IRS LifeCycle governance document and new Form 990 governance section fit into this discussion
- Discuss your role in exams
- Describe current IRS tools and other resources available
- Describe our next steps

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# What this Session is Not

- A course on nonprofit governance under state law
- An answer to all questions you might have about nonprofit governance
- A simple checklist of dos and don'ts
- The end of the governance discussion

# Most Important Take Aways

- When it comes to nonprofit governance, one size does not fit all
  - Governance issues vary depending upon type, size, structure, and culture of the organization
- It is our responsibility to administer the tax laws uniformly and fairly
  - Everyone in EO must understand why we are focusing on governance, what we mean when we say we will emphasize governance, and how we intend to do that across all of EO
    - Education and outreach, rulings and agreements, examinations

# Most Important Take Aways (cont.)

- Our job is to assess whether an organization has complied with tax laws
  - In some cases, this means looking at whether particular organization managers participated in decisions that resulted in excess benefits or other noncompliance (e.g., 4958 or PF excise taxes)
  - In other cases, it means looking at whether the organization took certain steps to assure the fairness of the arrangement to the exempt organization (e.g., taken steps to establish reasonableness of compensation)
  - It is not our job to determine the organization's governance structure, policies or practices, or to make decisions for them

# Background – Specific Actions by the Sector

- Panel on the Nonprofit Sector convened in 2004 to consider proposals to improve effectiveness and accountability of NP orgs., with particular attention to self-governance
  - Issued reports in 2005, 2006 and 2007
- Council on Foundations issued stewardship principles for private foundations in 2005
- American Law Institute project begun in 2000 to develop Principles of the Law of Nonprofit Organizations – draft issued in 2007
- ABA Coordinating Committee on Nonprofit Governance issued its Guide to Nonprofit Corporate Governance in the Wake of Sarbanes Oxley in 2005

# Background – Recent Action by the Sector

- Numerous governance education programs held for organization board members and officers, practitioners, policy makers
- Accrediting organizations that set and assess standards before giving stamp of approval
  - Organizations that rate charities based on standards for accountability or on public data or input
- Research, academic and public interest groups and centers who study governance and promote good governance principles and practices

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# States' Role in Governance

- Oversight by charity officials
  - Enforcement of state nonprofit corporation or trust statutes
  - Charitable trust principles
  - Charitable solicitation and fundraising registration and reporting
  - NASCO – National Association of State Charity Officials
- Audited financial statement requirements
- Examples of state statutes
  - Revised Model Nonprofit Corporation Act
  - California's Nonprofit Integrity Act of 2004, including governance provisions for charities



# Examples of Relevant State Law

- Who governs the organization – members or directors, trustees, and allocation of duties across them
- Who are the required officers of a corporation
- Business judgment rule and the decisions made by a governing body
- Duty of loyalty to the organization and duty of care
- Certain procedures and policies, including amendments to governing instruments
- Requirements regarding certain minimum or maximum board sizes or qualifications of directors
- Requirements regarding term limits for board members

# Congress and Governance: Sarbanes-Oxley

- Legislation responding to governance deficiencies in for profit world in last decade
- Generally not applicable to nonprofits, but does have limited application
- Imposes criminal liability on tax exempt and other organizations for:
  - Retaliation against whistleblowers that report federal offenses
  - Destruction of records with the intent to obstruct a federal investigation

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# Recent IRS History

- In early 2007 EO posted Preliminary Staff Discussion Draft on good governance practices
- Put together a draft governance section for the 990 which we released in June 2007
- Over course of second half of 2007, finalized 990 governance section – released in Dec. 2007
- Used that experience to design an educational tool on governance for charities – LifeCycle – which we released in Feb. 2008

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## Recent IRS History (cont.)

- April 2008 - released Form 990 draft instructions, including for governance questions
- April 2008 – TEGE Commissioner delivered speeches at Georgetown nonprofit conference addressing governance
- June 2008 – ACT issued its report on IRS role in nonprofit governance
- December 2008 – released official form and instructions for 2008 tax years (2009 filing season)
- December 2008 - EO Implementing Guidelines released, including governance project

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# Stakeholder Feedback

- ACT Report (June 2008) – The Appropriate Role of the IRS with Respect to Tax Exempt Organization Good Governance Issues
  - ACT - Advisory Committee on Tax Exempt and Government Entities
  - Comprised of experts in TEGE who volunteer to serve for specific terms – issue public reports
- Concern that we don't uniformly apply requirements within EO to all exempt organizations
  - Determination letters – sometimes insist on conflicts policies, on an independent board, or specific board size
  - Exam - practices may vary in terms of what we might require or accept as a corrective action plan to avoid revocation or other penalties (noted in ACT report)

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# ACT Report – Methodology

- Interviewed IRS and Treasury officials, state charity officials, and experts in the field
- Reviewed extensive set of general and specialized written materials and publications on the topic
- Reviewed for profit corporate governance materials, including Sarbanes Oxley
- Presented report to IRS Commissioner in June 2008
- Acknowledged IRS's longstanding stake and legitimate interest in governance issues as they related to compliance with federal tax laws
- Expressed concern IRS could drive behavior merely by asking about specific practices, causing organizations to adopt practices not suited to them

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# ACT Report – Conclusions and Observations

- IRS should continue to work with EO community
- Specific governance practices should be mandated only in rare circumstances
- Closer the nexus to tax compliance, the more appropriate the inquiry
- IRS should explain the specific relationship between tax compliance and each practice it is addressing
- Compliance Qs more appropriate than governance Qs or commentary
- Governance inquiries should be made in as neutral a manner as possible

# ACT Report – Conclusions and Observations (cont.)

- Qs about practices and approaches are typically better than Qs about policies
- IRS should expressly acknowledge when practices are not required
- IRS should expressly acknowledge that practices may be more appropriate for some orgs than for others, and that it respects the role of the governing body in making decisions
- Taking into account the absence of certain practices in determining whether to exam an org may be appropriate in certain circumstances
- Consistency and fair treatment by IRS are critical
- Education, implemented thoughtfully, is more appropriate than pressuring change



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# ACT Report – Observations Regarding IRS Examinations

- IRS is or should be considering the organization's actual operations in ascertaining whether the organization qualifies for exemption
- Where there are violations of standards for exemption, IRS rightfully has a greater interest and duty, and correspondingly, increased latitude to address misbehavior
- ACT did not find significant guidance as to how IRS takes governance issues into account in the examination process; found this troubling

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# Nonprofit Governance Studies

- Study of nonprofit governance practices and policies is increasing
- Too soon to tell whether there are trends or patterns, but these studies should help inform us and others about what is going on in the sector
- Two in particular we mention today to give you a flavor of what is being studied
  - 2005-2007 by Urban Institute
  - 2007 by BoardSource®

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# 2005-2007 Urban Institute Center on Nonprofits and Philanthropy Study

- Survey of over 5,100 nonprofits
  - Stratified random sample, self reported data
  - Covered 2005
  - UI described it as first-ever national representative study of nonprofit governance
- 70% have trouble recruiting board members (p.16)
- Having CEO serve on board results in less engaged board and may undermine stewardship role of the board (p.22)
- Large board size doesn't necessarily weaken board performance or detract from board engagement (p.17)

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## Urban Institute (cont.)

- Smaller nonprofits that engage in financial transactions need to have more formal policies in place (pp. 10 and 22)
- Larger organizations need to more often have other board members review transactions (pp. 10 and 22)
- Best practice guidelines or adopting new policies will not be sufficient to strengthen board performance and accountability (p.23)

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## Urban Institute (cont.) – Some Statistics

- 67% of nonprofits have audits (p.4)
- Half of nonprofits have a conflict of interest policy, 29% required disclosure of financial interests (p.9)
- Less than 1% of nonprofits made loans to board members (p.4), but many buy/rent goods or services from board members, which more often than not does not yield savings in the way of below market rates (p.22)
- 2% compensate board members (p.11)
- 75% of organizations did not require board members to disclose financial interests in entities doing business with the nonprofit (p.8)

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## *Nonprofit Governance Index 2007,* BoardSource® (2007)

- June 2007 survey of 2,152 nonprofit leaders on board composition, structures, oversight and performance
  - 1,126 chief executives; 1,026 board members
  - Not a statistical sample
- 37% under \$1M budget size; 37% \$1M to \$5M; 26% \$5M or over
- 80% public charities, 9% private foundations

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## *Nonprofit Governance Index 2007,* BoardSource® (2007)

- 99% of NPs have a written mission statement (p.5)
- 92% of NPs have an external financial audit (p.17)
  - 54% of NPs have an audit committee (p.17)
- Board size averages 16 voting members (p.10)
- 14% of chief executives are voting members of their boards; 4% are also board chair (p.10)
- Boards meet an average of 7 times a year (p.14)
- Boards meet an average of 16.5 hours a year (p.14)

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# *Nonprofit Governance Index 2007,* BoardSource® (2007)

- *Fundraising (p.6):*
  - 68% of charities require board members to contribute
  - 61% require them to identify donors for fundraising
- 3% of NPs pay board members a fee or honorarium, 29% reimburse for travel and meeting expenses (p.12)
- 67% of full boards approve chief executive's total compensation package, 65% consider salary at comparable organizations (p.18)
- 88% have a conflict of interest policy (p.16)



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# Today's Focus is Public Charities

- Governance structures vary based on size, type, structure, and culture of organization – one size does not fit all
- Not all 501(c)(3)s are alike
  - Public charities versus private foundations
- Member organizations such as trade associations and social clubs have special considerations
  - They are accountable to members as well as to the public
- Cannot apply what you hear or learn today equally to all types of exempt organizations
- Good governance is important to safeguarding assets and operating to further exempt purposes

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# Background – Governance Life Cycle for Charities

- The LifeCycle governance document is an educational tool aimed at helping organizations and their governing bodies consider certain governance practices and policies during both the formation and operation of the organization
  - Not recommended practices but encourage certain items
  - Generally applies to public charities
- Advises organizations what they will be required to report about on new 990
- Six topic areas – mission, organizational documents, governing body, policies, financial statements and 990 reporting, transparency and accountability

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# Governance on the Form 990

- The newly revised Form 990 is multi-purposed
  - Provides public transparency concerning an organization's governance structure, policies, and activities.
  - Serves as a tool for use in future compliance efforts.
- Governance questions are generally located in Part VI of core form, but some questions are also located elsewhere
  - E.g., compensation section and Schedule J; Schedule M
  - Also, Part XI asks some financial reporting questions

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# Form 990, Part VI

- Heart of the new 990 governance reporting
- 20 questions (28 including subparts) in Part VI governance section
- Part VI divided into three parts
  - Governing body and management – who is governing the organization?
  - Policies – what policies and practices does the organization have in place?
  - Disclosure and transparency of certain information

# Form 990, Part VI – Terms You Need to Know (Glossary or Part VI Instructions)

- *Glossary terms*
- Governing body
- Voting member, independent
- Officer, director or trustee, key employee
- Family relationship
- Business relationship
- Conflict of interest policy
- *Part VI definitions*
- Governing documents
- Member
- Conflict of interest
- Whistleblower policy
- Document retention and destruction policy
- Joint venture policy

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# Form 990, Part VI – Who Governs the Organization?

- 1a – number of voting members
- 1b – number of independent voting members
- 3 – delegate any management duties customarily performed by ODTKEs to others?
- 4 – significant changes in org docs?
- 6 – have members or stockholders?
- 7a – may members elect board members?
- 7b – governing body decisions subject to approval by members?

# Form 990, Part VI – What Policies and Practices are in Place?

- 8a & 8b – contemporaneously document meetings of governing body or committees authorized to act on behalf of the body
- 9a & 9b – local branches and any written policies regarding them
- 10 – copy of 990 provided to governing body before filed; any review process?
- 12 – conflicts of interest
- 13 – whistleblower
- 14 – document retention and destruction
- 15 – process to determine compensation of top management official, other officers and key employees, satisfy 3-part rebuttable presumption procedure?
- 16 – if invested in a JV, does it have a policy in place to assure safeguarding of assets and exemption?

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# Form 990 Part VI – Conflicts, Business and Family Relationships

- 2 – any ODTKE have a business or family relationship with another ODTKE?
- 5 – did organization become aware of a material diversion of assets?
- 12a – written conflict of interest policy?
- 12b – ODTKEs required to annually disclose potential conflicts?
- 12c – does organization regularly and consistently monitor and enforce compliance with the conflicts policy?



# Form 990 Part VI – Transparency, Points of Contact

- 17 - List the States where copy of 990 is required to be filed
- 18 - Check whether org makes available on its web site, another's web site, or upon request, its 1023/1024, 990 and 990-T
- 19 - Describe in Schedule O whether, and if so, how the org makes available to the public its governing documents, conflict of interest policy, and financial statements
- 20 - Person in possession of books and records
- 11 – addresses to locate officers and directors

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# Form 990 Part VI

- Numerous questions - many require a narrative response by going to Schedule O
  - Schedule O very important part of new 990 governance reporting
  - Organization also may use it to describe its governance structure and practices
- Introduction to instructions addresses absence of mandated practices, no one size fits all
- Every organization is required to respond to each question in Part VI.

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# Governance on the Form 990

## Mission Statement

- The IRS encourages charities to establish and regularly review, the organization's mission.
- A clearly articulated mission, adopted by the board, serves to explain the charity's purpose and guide its work.
- Form 990 asks the organization to describe the organization's mission in two places:
- Part I, Line 1 (summary page)
- Part III, Line 1 (statement of program service accomplishments)

# Governance on the Form 990

## Governing Body

- The governing body is a group of persons authorized under state law to make governance decisions on behalf of the organization and its shareholders or members, if applicable.
- Part VI, Section A, Lines 1a and 1b request information regarding the **number of voting members** of the organization's governing body *and* how many of those voting members are **independent**.
- **Voting member** - someone with **power to vote on all matters** that come before the body
  - Not the same as a director for other 990 purposes, which is defined as someone with any voting rights
  - Different voting rights are to be explained in Schedule O

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# Governance on the Form 990

## Board Member Independence

- Board independence is relevant to the issue of whether board members serve public interests or private interests
- There are other meanings of what it means to be independent for other purposes
- For purposes of Form 990 reporting, an independent board member is one who:
  - Was not compensated as an officer or other employee of the organization or a related organization.
  - Did not receive total compensation or other payments exceeding \$10K during the organization's tax year from the org or from a related org as an independent contractor.
  - Was not involved (nor was a family member involved) in a transaction with the org that is required to be reported on Schedule L.
- May rely on reasonable efforts process – see instr.

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# Governance on Form 990

## Size of Governing Body

- There is no right answer to the question “how many members should a board have?”
  - 990 asks this question in large part to get a sense of what portion of the board with authority to govern is independent or consists of corporate officers, family, etc.
- A good size depends on many things, including:
  - Age of organization;
  - Nature and geographic scope of mission and activities;
  - Variety of expertise required; and
  - Fundraising needs.

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# Governance on the Form 990

## Relationships

- Part VI, Section A, Line 2 seeks information on family and business relationships between officers, directors, trustees, or key employees (ODTKEs).
- If family or business relationships do exist among ODTKEs, they must be identified in Schedule O.
- Examples of business and family relationships are discussed in detail on pages 16 and 17 of the revised Form 990 instructions.
- May rely on reasonable efforts process – see instr.

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# Governance on Form 990

## Delegation

- Part VI, Section A, Line 3 asks whether organization delegates control over management duties to a management company or other person.
- Management duties include, but are not limited to, hiring, firing, and supervising personnel, planning or executing budgets or financial operations, or supervising exempt operations or unrelated trades or businesses for the organization.
- Management duties **DO NOT** include - administrative services (i.e. payroll processing) or investment management unless the filing organization conducts investment management for others.
- Question designed to show who is running the organization. Does governance or management of the organization rest with the governing body or officers, or is it vested elsewhere?



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# Governance on the Form 990

## Organizational Documents

- Provide framework for the organization's governance and management.
- State law often prescribes the type of organizational document & content.
- IRS requires submission of organizational documents with application for exemption.

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# Governance on the Form 990

## Organizational Documents

- **Part VI, Section A, Line 4** – What significant changes to the organizational documents have occurred since the last Form 990 was filed or have never been reported?
- Includes changes to articles, trust instrument, constitution, or any other organizational document.
- Not all changes must be reported

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# Governance on the Form 990

## Organizational Documents

- Reportable changes to organizational documents include:
  - Exempt purpose or mission;
  - Number, composition, qualifications, authority or duties of officers, key employees or voting members;
  - Role of stockholders or membership in governance;
  - Distribution of assets upon dissolution;
  - Provisions to amend documents;
  - Quorum, voting rights or voting approval requirements;
  - Policies/procedures regarding compensation of officers, directors, trustees or key employees; conflicts of interest, whistleblowers, or document retention/destruction; and
  - Composition or procedures contained within organizing documents or bylaws of an audit committee.

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# Governance on the Form 990

## Material Diversion of Assets

- **Part VI, Section A, Line 5** – Did the organization become aware during the year of a material diversion of the organization's assets?
  - Any unauthorized conversion or use of assets other than for authorized purposes (e.g., theft or embezzlement, but not authorized transfer of assets to a joint venture)
  - Material if amount exceeds lesser of \$250,000 or 5% of total assets/gross receipts
- If yes, must explain the nature of the diversion, amounts involved, corrective actions taken to address it, and pertinent circumstances, on Schedule O

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# Governance on the Form 990

## Members or Stockholders

- Part VI, Section A, Line 6: Does the organization have members or stockholders?
  - Answer “yes” if the org is a stock corporation, a joint-stock company, a partnership, a joint venture or a limited liability company, or if it is a non-stock, or nonprofit corporation or association *with members*.
  - Answer “no” if the org is a trust for federal tax purposes.
  - NOTE: this highlights differences between corporations and trusts, and member and non-member organizations.

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# Governance on the Form 990

## Approval or Election of Board Members

- Part VI, Section A, Line 7a – Does the organization have members, stockholders or other persons who may elect one or more members of the governing body?
- Part VI, Section A, Line 7b – Are the decisions of the governing body subject to approval by members, stockholders, or other persons?
- If the organization answers “yes,” they must describe the circumstances in Schedule O.
- We ask these questions to learn who has authority to select the individuals with power to govern the organization, or who has final decision making authority in membership organizations

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# Governance on the Form 990

## Contemporaneous Documentation

- Part VI, Section A, Line 8 - Did the organization contemporaneously document the meetings held or written actions undertaken during the year by:
  - the governing body *and*
  - each committee with authority to act on behalf of the governing body?
- We ask this question to learn whether the organization is taking steps to document its governing body actions and decisions so that who participated in the decisions, and the rationale for the decisions, is documented

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# Governance on the Form 990

## Local Chapters, Branches, Affiliates

- Part VI, Section A, Line 9 asks whether the org has local chapters, branches, or affiliates and whether written policies and procedures govern such entities to ensure that their operations are consistent with those of the organization.
  - Note: The central/parent organization of a group exemption ruling is required to exercise oversight over its subordinate organizations as a condition of the group exemption.
- Some organizations use local chapters or branches to conduct activities; it is important to know whether local operations and assets are being conducted and used consistently with the organization's broader purposes and mission



# Governance on the Form 990

## Provision of the 990 to Board Members

- Part VI, Section A, Line 10 – Was a copy of the Form 990 provided to the *voting members* of the organization's governing body prior to filing with the IRS?
  - Although not required to do so by the Internal Revenue Code, some organizations provide copies of the 990 to its governing body, either prior to or after it is filed.
  - All organizations must describe in Section O the process, if any, used to review the Form 990.

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# Governance on the Form 990

## Provision of the 990 to Board Members (cont.)

- These questions are asked to determine whether the governing body members are aware of the information contained in the annual information return filing, and if they review the filing
- Practices will vary based on size, culture, and type of organization, but each organization should consider the process that is best suited to its needs
  - Large orgs might use a committee, for example

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# Governance on the Form 990

## Contact Information

- **Part VI, Section A, Line 11:** Asks whether there are any officers, directors, trustees, or key employees listed in compensation schedule that cannot be contacted at organization's mailing address
- If so, provide names and contact addresses in Schedule O
- Designed to protect privacy and safety of such persons by not asking for their home addresses

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# Governance on the Form 990

## Part VI, Section B: Policies

- Conflicts of Interest;
- Whistleblower;
- Document Retention and Destruction;
- Executive Compensation; and
- Investments & Joint Ventures.

# If Governance Policies are not Required, Why do We Ask about Them?

- Does the existence of a policy assure good behavior and compliance? Of course not.
- But having policies in place should provide the framework which an organization's directors, officers, employees and volunteers may use to address issues that arise
- Written policies generally clearer than verbal
- But policies are not enough: they are only effective if they are used and followed

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# Governance on the Form 990

## Conflict of Interest

- Arises when a person in a position of authority may benefit financially from a decision he or she makes in that capacity.
- Includes indirect benefits (i.e., to family members or a business the individual is closely associated with)
- Does not include a person's competing or respective duties to the organization and another organization (i.e., serving on boards of either organization that do not involve a material financial interest, or benefit to such person) – “conflict of loyalty” issues.
- 990 asks conflicts questions to determine whether the organization has a formal policy and whether it is being implemented – policy is not required, however

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# Governance on the Form 990

## Conflict of Interest Policy

- Part VI, Section B, Line 12 – Did the organization have a written conflict of interest policy and was it regularly and consistently monitored and enforced?
- Line 12a – Did the organization have a policy?
- Many conflicts policies define conflicts; identify individuals covered; facilitate disclosure of information to help identify conflicts; and specify procedures to manage conflicts.

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# Governance on the Form 990

## Conflict of Interest Policy

- **Line 12b** – Are officers, directors, trustees, and key employees required to disclose annually interests that could give rise to conflicts?
- May include list of family members, substantial business and investment holdings, etc.
- **Line 12c** – Does the organization regularly and consistently monitor and enforce compliance with the policy?
- How is this done and how do they deal with potential or actual conflicts; who is covered; how are conflicts determined & reviewed, etc.



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# Governance on the Form 990

## Whistleblower Policy

- Policies that allow staff, volunteers, or others to report suspected wrongdoing within the organization.
- Helps boards and senior managers become aware and address problems before serious harm is done to the organization.
- Assists in complying with legal provisions that protect individuals that report suspected wrongdoing from retaliation. See, for example, Sarbanes Oxley provisions regarding whistleblower protections and liability. Some states have similar requirements.

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# Governance on the Form 990

## Whistleblower Policy

- Theft;
- Misleading financial reporting;
- Improper or undocumented financial transactions;
- Improper destruction of records;
- Improper use of assets;
- Violations of conflict of interest policies; and
- Other improper occurrences regarding cash, financial procedures or reporting.

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# Governance on the Form 990

## Whistleblower Policy

- **Part VI, Section B, Line 13** – Does the organization have a written whistleblower policy?
- Encourages staff to come forward with credible information on illegal practices or violations; specifies the organization will protect the individual from retaliation; and identifies persons to whom such information can be reported.

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# Governance on the Form 990

## Document Retention and Destruction

- **Part VI, Section B, Line 14** – Did the organization have a written document retention and destruction policy?
- As stated earlier, while federal Sarbanes Oxley legislation generally doesn't pertain to tax-exempt organizations, it does impose criminal liability on tax-exempt as well as other organizations for destruction of records with intent to obstruct a federal investigation.

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# Governance on the Form 990

## Executive Compensation

- No mandated process for determining compensation
- Rebuttable presumption 3-prong test
  - Specifically applies to public charities and (c)(4)s subject to 4958 excess benefit transaction tax
    - Compensation determined by persons with no conflict of interest
    - Based upon proper comparability data
    - Documented
- Though not required - good practice for all types of exempt organizations, not just those subject to 4958 provisions
- Accordingly, 990 now asks this question of all organizations

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# Governance on the Form 990

## Executive Compensation

- **Part VI, Section B, Line 15** – Did the process used for determining compensation of CEO and other officers & key employees include a review and approval by independent persons, comparability data and contemporaneous substantiation?
- Organizations must describe the process used, positions involved, and the year the process was last undertaken in Schedule O.
- Note that Form 990, Part VII, and Schedule J also solicit compensation information.

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# Governance on the Form 990

## Executive Compensation

- Focus on process used to establish compensation
  - Were compensation payments approved in advance by an authorized body who did not have a conflict of interest?
  - Did the organization obtain & rely on appropriate data to make the decision?
  - Did the organization adequately document the basis for the decision and compensation arrangement?

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# Governance on the Form 990

## Executive Compensation

- Comparability Data:
  - Should look at compensation paid by similarly situated organizations for functionally comparable positions.
  - IRS looks at independence of any compensation consultants used and the quality of the study.
  - For sec. 4958: Once the elements of the presumption are met, IRS may rebut only if it develops sufficient contrary evidence to rebut the probative value of the comparability data relied upon by the authorized governing body.
  - EO recently announced it intends to focus on quality of the comparables, of both exempt and for profit organizations, used in compensation studies



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# Governance on the Form 990

## Investments & Contribution of Assets

- EOs are increasingly investing in joint ventures, for-profit entities, and complicated & sophisticated financial products or investments.
- Important for all types of exempt organizations to consider the terms and conditions of the joint ventures and other investments they make, including as to risk and the fairness of the deal to the organization
- 990 asks questions regarding JV investment policy to determine whether organization has formal safeguards in place to protect exempt assets and protect against inurement, private benefit, prohibited political intervention, etc.

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# Governance on the Form 990

## Investments & Contribution of Assets

- **Part VI, Section B, Line 16a** — Did the organization invest in, contribute assets to, or participate in a joint venture or similar arrangement?
- Joint Venture – agreement to jointly undertake a specific business enterprise, investment or exempt-purpose activity without regard to (1) whether organization controls venture; (2) what the legal structure is; or (3) whether venture is treated as a partnership for federal income tax purposes.

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# Governance on the Form 990

## Investments & Contribution of Assets

- **Part VI, Section B, Line 16b** – Has the organization adopted a written policy or procedure to evaluate its participation and establish steps to safeguard assets & exempt status? Considerations include:
  - Sufficient control to ensure venture furthers exempt purposes?
  - Priority to exempt purposes over maximizing profits?
  - Activities that would jeopardize the organization's exemption?
  - Contracts with organization arms-length?

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# Governance on the Form 990

## Section VI, Part C: Disclosure

- Line 17: Organizations must list states where its Form 990 is required to be filed.
- Line 18: Organization must indicate how it makes its Forms 1023 (or 1024 if applicable), 990, 990-T (501(c)(3)s only) available for public inspection
- Line 19: Organization must describe in Schedule O whether and how it makes its governing documents, conflict of interest policy and financial statements available.

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# Governance on the Form 990 – Part XI

## Financial Reporting Questions

- Financial Statements:
  - Organizations that file Form 990 will find that Part XI, Line 2, asks whether the organization's financial statements were compiled, reviewed, or audited by an independent accountant.
  - Part XI, Line 3 asks whether, as a result of a federal award, the organization was required to undergo an audit as set forth in the Single Audit Act and OMB Circular A-133.

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# Governance on the 990 – Other Questions on Various Schedules

- Other governance policy questions are sprinkled throughout the form
- Examples include:
  - Schedule J – compensation and expense reimbursement arrangements
  - Schedules F and I – grant making arrangements
  - Schedule H – accountability to community the hospital serves
  - Schedule M – unusual gift arrangements

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# Governance

## IRS Authority

- The Internal Revenue Code does not expressly refer to governance practices, policies, or requirements
- Primarily the responsibility of State regulators
  - Satisfaction of State requirements is not always dispositive for federal tax purposes
- Although the IRS generally is not authorized by the Code to sanction particular governance failures, it enforces:
  - Prohibitions on private benefit and inurement
  - Rules regarding excess benefit transactions and other excise tax provisions applicable to organizations and managers
  - Statutory and regulatory requirements regarding organized and operated exclusively for exempt purposes, dedication of assets for exempt purposes, other compliance issues.

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# EO Next Steps

- Develop examination checksheet regarding various governance topics to explore link between good or bad governance and compliance with tax laws
- Incorporate Form 990 questions and responses into compliance initiatives
- Continue training - what further training or emphasis is needed?



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# Governance Project

## Objective

- Long term study by IRS – this is not something we will do quickly
- Will include several segments along with different activities over the span of several years in order to accomplish the project objective.
  - Compliance Checks
  - Examinations

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# Governance Project

## Draft Checksheet

- The check sheet will be developed with the assistance of exam agents as well as outside stakeholders.
- Additional training on the check sheet and governance in general will be offered once the check sheet is finalized.

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# Some Potential Areas For Additional Governance Training

- Material diversion of assets
- Executive compensation
- Transactions with insiders and related entities
- Employment tax payments
- Fundraising and grant making activities
- Special private foundation considerations
- Member organizations
- Tax records and substantiation

# Where do you go if you have questions to learn more about nonprofit governance in general?

- Outside sources – not authoritative in legal sense but excellent discussions of issues
  - ACT Report
  - Independent Sector/Nonprofit Panel Reports
- IRS sources
  - IRS LifeCycle governance document
  - Governance Project Team Members

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# Where do you go if you want to discuss what to do in a particular examination?

- Contact your manager
- Contact other agents
- Contact Governance Project Team Members

# Governance Project

## Team Members

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# Summary of Main Points

- Each organization needs to decide for itself how best to govern – one size does not fit all
- Not our role to tell them how to govern
- Form 990 governance questions serve transparency and compliance goals
- All of EO must understand our role in the area and what we are trying to accomplish in the areas of education and outreach, rulings and agreements, and examinations
- We will keep you posted and seek your input along the way

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